

**THE COMMONWEALTH OF MASSACHUSETTS  
BEFORE THE DEPARTMENT  
OF TELECOMMUNICATIONS AND ENERGY**

**BOSTON GAS COMPANY**

**D.T.E. 03-40**

**TESTIMONY OF TIMOTHY NEWHARD  
ON BEHALF OF  
THE ATTORNEY GENERAL**

**August 11, 2003**

**Boston Gas Company  
D.T.E. 03-40  
Testimony of Timothy Newhard  
August 11, 2003**

1 Q: Please state your name and business address.

2 A: My name is Timothy Newhard. My business address is Office of the Attorney General,  
3 Public Protection Bureau, Utilities Division, 200 Portland Street, Boston, Massachusetts  
4 02114.

5  
6 Q: What is your position with the Office of the Attorney General ?

7 A: I am a financial analyst with the Utilities Division.  
8

9 Q: Please describe your educational background.

10 A: I graduated from the University of Maine at Orono in 1979 with a Bachelor of Science  
11 Degree in Engineering Physics. In 1981, I graduated from Northeastern University with a  
12 Masters Degree in Business Administration with concentrations in finance and  
13 economics. I passed all of the Certified Public Accounting exams in 1985 and  
14 successfully completed all of the Chartered Financial Analyst exams in 1991.  
15

16 Q: Please describe your work experience.

17 A: I have been employed in the Office of the Attorney General since 1981 as a financial  
18 analyst, working on all aspects of utility rate cases. I have advised the Office on policy  
19 and technical issues regarding utility matters and testified as an expert witness on various  
20 cost of service issues. Most recently, I have been involved in the restructuring of the

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1 energy industry in Massachusetts.

2  
3 Q: Have you presented testimony before the Massachusetts Department Of  
4 Telecommunications and Energy, formerly the Department of Public Utilities (the  
5 "Department") ?

6 A: Yes. I have presented testimony before the Department in gas, electric, and telephone  
7 cases.

8  
9 Q: Please describe the purpose of your testimony in this case.

10 A: The purpose of my testimony is to discuss statements made by Boston Gas Company's  
11 cost of capital witness, Mr. Moul, regarding the Company's proposed pension  
12 reconciliation mechanism.

13  
14 Q: Please summarize you testimony and recommendations.

15 A: The introduction of a reconciliation adjustment mechanism by a rate regulated utility  
16 company to recover base rate costs generally will reduce the cost of capital for the utility.  
17 Specifically, the pension reconciliation adjustment mechanism that the Company  
18 proposes here would shift the risks associated with variability of employee expenses from  
19 the Company's shareholders to the Company's customers. Therefore, contrary to Mr.  
20 Moul's statements in his rebuttal testimony, Boston Gas Company's cost of capital will

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1 decrease, if the Department approves the Company's pension expense reconciliation  
2 adjustment mechanism.

3  
4 Q: Please summarize Mr. Moul's testimony.

5 A: The Company proposes, in this case, a new reconciliation adjustment mechanism for the  
6 pension expense it currently recovers through base rates. The Attorney General's witness  
7 David Effron testified that the proposed pension reconciliation mechanism is  
8 unnecessary, would be inappropriate ratemaking policy, and would shift the risk of  
9 pension expenses from the Company to its customers. Mr. Moul's rebuttal testimony to  
10 Mr. Effron's testimony concludes that the approval of Boston Gas Company's pension  
11 reconciliation mechanism will maintain the status quo for the Company and its customers  
12 and will cause no change in the Company's cost of common equity. See Exhibit  
13 KEDNE/PRM-4, page 3.

14  
15 Q: Do you agree with Mr. Moul's conclusions?

16 A: No. Neither of these conclusions are correct.

17  
18 Q: Please explain.

19 A: First, Mr. Moul's statement that the approval of Boston Gas Company's pension  
20 reconciliation adjustment mechanism will maintain the status quo for the Company and

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1 its customers is flatly wrong. The Company's pension reconciliation adjustment  
2 mechanism will shift the risks of pension expenses from the Company's shareholders to  
3 its customers, leaving the Company's earnings unaffected by changes in its pension  
4 expenses. On the other hand customer's rates will now vary more as the Company  
5 passes through all changes in the pension expenses to customers.

6  
7 Currently, the Department establishes the Company's base rates by using a representative  
8 level of just and reasonable costs of providing the distribution service, including pension  
9 expense. Once those rates have been set by the Department, in its base rate Order, they  
10 remain fixed until the Company petitions the Department, and it orders new rates. During  
11 that time, the Company and its shareholders are at risk for any changes in those expenses,  
12 as the shareholders are for all the other costs used to set those rates.

13  
14 The Company proposes, in this case, a new reconciliation adjustment mechanism for the  
15 pension expense it currently recovers through base rates. The reconciliation mechanism  
16 allows the Company to change the rates it charges to customers to recover its expense  
17 dollar for dollar. As a result, the Company's earnings will not be affected by its pension  
18 expense. The risk associated with the pension expense has been shifted to the Company's  
19 customers, who will now incur annual rate changes they didn't experience before. This  
20 shift in the risk associated with pension expense recovery makes the Company's

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1 shareholders better off and the Company's customers worse off.

2  
3 Second, as a result of the shift of the risk associated with pension expense from Boston  
4 Gas Company shareholders to its customers, the Company's cost of capital will decrease.  
5 The investment risk – return trade off posits that the expected return from an investment  
6 is a function of investors' perceived risk associated with the investment. As the  
7 perceived risk in the investment increases, so will the expected return. Similarly, as the  
8 perceived investment risk decreases, the expected return will also decrease. Since the  
9 proposed pension reconciliation mechanism reduces the Company's investment risk, the  
10 investors' required will also decrease. Therefore, if the mechanism were approved by the  
11 Department, it must also make an adjustment to reduce the Company's cost of capital  
12 accordingly.

13  
14 Q: Please summarize your testimony and conclusions.

15 A: As the Attorney General's witness Dave Effron stated in his testimony, the Department  
16 should reject the Company's pension reconciliation adjustment mechanism, since it is  
17 unnecessary and it would create inappropriate new ratemaking policy. Furthermore,  
18 approval of such expense mechanisms shifts the risk associated with the expense from the  
19 Company's shareholders to its customers, reducing the cost of capital for the Company.

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1       Q:     Does that conclude your testimony ?

2       A:     Yes. It does.